Macro Economic Report
January 15, 2023

Monetary Policy Statement H2'FY23

A Flexible Stance, Ahead of Challenges

Monetary Policy Statement (MPS) H2'FY23 Revision: Key Figures

Figures in Percentage	FY22 Actual	FY H1'23 Review		Targets for FY H2'23 6M (up to Jun'23)		
		Targets	Actual	Target	Revised	Change
GDP Growth Rate	7.25	n/a	n/a	7.50	6.50	-100 bps
Inflation	6.15	n/a	7.70	6.30-7.50	7.50	
CRR	4.00	4.00	4.00	4.00	4.00	
Repo Rate	5.50	5.50	5.75	5.50	6.00	+50 bps
Reverse Repo Rate	4.00	4.00	4.00	4.00	4.25	+25 bps
Bank Rate	4.00	4.00	4.00	4.00	4.00	
Reserve Money Growth Rate	-0.30	9.00	17.40	9.00	14.00	+500 bps
Broad Money Growth Rate	9.40	10.00	8.40	12.10	11.50	-60 bps
Domestic Credit Growth Rate	16.20	16.90	15.10	18.20	18.50	+30 bps
Private Sector Credit Growth Rate	13.70	13.60	12.80	14.10	14.10	
Public Sector Credit Growth Rate	29.10	33.30	26.60	36.00	37.70	+170 bps
Net Foreign Assets Growth	-11.90	-10.10	-22.60	-2.10	-11.90	-980 bps
Net Domestic Assets Growth	17.20	16.60	18.50	16.00	17.90	+190 bps

Source: Bangladesh Bank, MPS
Note: Inflation is based on 12-month average. Source Table: 1, 4 MPS H2'FY23

MPS H2'FY23 takes a gentle turn from previous conservative stance, looking to contain demand side pressures via rates and other policy tools, while addressing the supply side factors via intervention, monitoring and other accommodative policies. Acknowledging the external and internal worries, in MPS H2'FY23 BB revises its inflation, broad money, credit growth and a number of targets. Notable policy moves include raising policy rates, removing deposit rate floor as well as partial loan rate ceilings.

Alongside policy rate revise, this MPS seeks non-conventional alternatives to contain inflation: sector focused financing flow, stricter control on importing non-essentials, promoting import-substituting businesses. Below is our assessment of the latest monetary policy statement.

Analyst Notes:

Economic Expectations

- **GDP growth is revised to 6.50%. Headline Inflation ceiling is modified to 7.50% by Jun 2023.**
- As of now, Bangladesh has been facing inflationary, liquidity, and exchange rate pressures in the last few months, primarily from external shocks. High NPL and governance issues in FIs are current concerns for financial stability.
- Economic expectations are stable as per BB. Key factors for disruptions include Russia-Ukraine war, interest rate hikes by US Fed, and Covid re-emergence in China. Improvement in any of these would propel Bangladesh's future economic gains. BB is optimistic about the resilience of Bangladesh should any of these major factors turn adverse.
- Exchange rate pressure to normalize over (i) import demand curbing policies and (ii) Export and remittance enhancing steps.
- On inflation front, domestic prices to ease ahead in near future from falling commodity prices globally, and better agri-production locally.
- BB is skeptical regarding Bangladesh economy getting benefit of declining global energy prices, owing to administered prices in the country. Hence, it supports periodic fuel price adjustment in tandem with global prices.

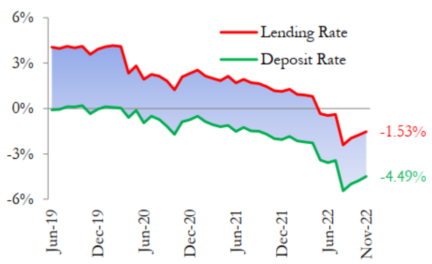
Policy Rates

- BB raised the policy rates by 25 bps. Repo rates were raised to 6.00% from 5.75%. BB earlier raised this from 5.50% to 5.75% in September 2022. Reverse Repo rate has been raised to 4.25% from 4.00%.
- However, we expect this to stay ineffective given that interest rate ceiling is largely in effect.

Interest Rate Environment:

- BB acknowledges the average real deposit rates are in negative territory since ~Jun 2020. Meanwhile, real lending rate also has been negative since Jun 2022 primarily over high inflation. As of November 2022, real deposit and lending rates are -4.49% and -1.53% respectively. (Chart 19, MPS H2'23)
- **Lending Rate Cap Revision:** Consumers' Credit relaxed up to 12%. No Cap for credit card loans. Other rate ceilings remain as is for the moment, and relaxations on these "may" come in suitable economic conditions.
- **Deposit Rate Revision:** BB has gone for complete removal of deposit rate floor.

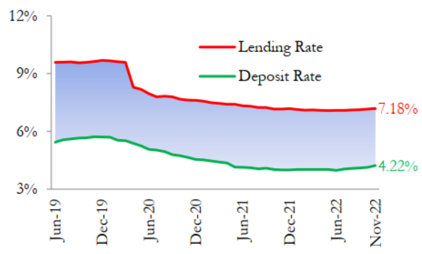
Chart 19: Weighted Average Real Interest Rates



Source: Bangladesh Bank

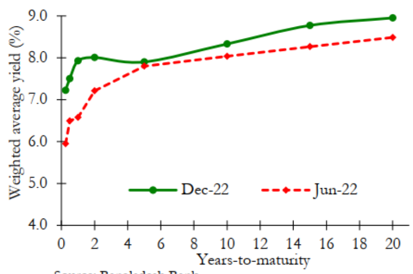
- **Analyst Comment:** The removal of floor rate is contrary to depositors' interest who are already facing negative real rates. BB is eyeing the floor removal to aid deposit growth in banks, which implies banks to go for more deposit but be able to offer lower deposit rates. We may see this causing further drain on liquidity as (i) depositors are encouraged to look for positive real return in high inflationary situation should banks go for lower deposit rates, and (ii) offering higher deposit rates strain banks' already weakening spread, in absence of return opportunities. Taking the liquidity aspect in the system alongside pre-existing NPL & governance issues, we translate this to evolve in a scenario where weaker banks would go for higher rates to grow deposits, while stronger banks get more deposits despite lower rate as depositors' 'flight to quality' shifts more liquidity to better banks. The net impact can be another round of increase in call money rates, continual pressure build-up on lending rate, and lower liquidity in a significant part of banking system.
- With loans and deposits both earning negative, banks are making money on the depositors instead of lending!
- GoB securities are offering higher than average lending rates from 1 year and onwards – driving banks' focus on profiteering from GoB investments (Chart 20, MPS H2'23).

Chart 18: Weighted Average Nominal Interest Rates



Source: Bangladesh Bank

Chart 20: Yields on Government Securities

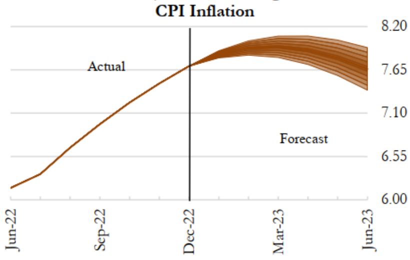


Source: Bangladesh Bank

Inflation Management

- The inflation target has been updated from 5.6% to 7.5% in FY23. Currently, 12-month average inflation stands at 7.7% (as of Dec'22). BB predicts inflation to peak in March 2023, ranging around 7.85%-8.05% (Chart 15, MPS H2'23).
- Since the cost-push from supply chain disruptions caused the current inflationary environment, BB considers making appropriate supply-side interventions necessary to sustain economic growth.
- Following factors may give inflation a breather –
  - Downward global price trend of most commodities
  - Promoting import substitutes and dissuading imports of non-essentials (curbing imported inflation)
  - Better yields of Aman and Boro paddies during next two seasons, securing food supply and reducing food inflation
  - Easing up of inflation in India, one of the major trade partners of Bangladesh
- However, there are concerns that prompted BB to keep a high inflation target for FY23-
  - No peaceful resolution of Russia-Ukraine war in sight, straining supply chain of essential commodities and fuel
  - Ongoing waves of COVID-19 in China, with a potential supply chain disruption issue
  - Swelling prices of construction materials translating to higher asset prices
- BB has stepped up by raising Repo rate by 25 bps, from 5.75% to 6.00%, and raising reverse repo rate by 25 bps, from 4.00% to 4.25%.
- **Analyst Comments:** Like most other central banks, BB has responded to soaring inflation with a policy rate hike. Also, it has resorted to non-conventional alternatives to contain inflation, such as sector focused financing flow, stricter control on importing non-essentials, and promoting import-substitute businesses. If the external situation does not worsen significantly, BB is expecting to keep inflation within the target range.

Chart 15: Projection of Average General CPI Inflation

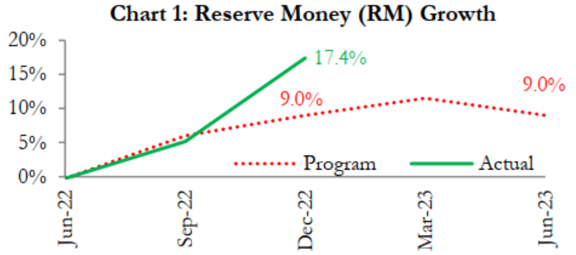


Source: BB's Research Team Projection Based on BBS Data

Broad Money Targets

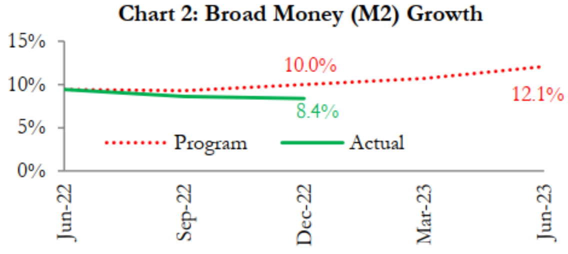
- **Analyst Comments:** It appears that alongside US dollar sales, BB is willing to tackle the liquidity need by focusing on money printing to raise Reserve Money, a major part of which is going to be channelled to public credit by FY23. While we can consider the fact that lower ADP implementation has historically resulted in weaker than planned achievement of targets, in FY23 scenario may turn different considering this being a pre-election year. More money printing can also aid in managing internal liquidity; however, this comes with a risk of further fuelling inflation and/or lowering BDT value.

Chart 1: Reserve Money (RM) Growth



Source: Bangladesh Bank.

Chart 2: Broad Money (M2) Growth



Source: Bangladesh Bank.

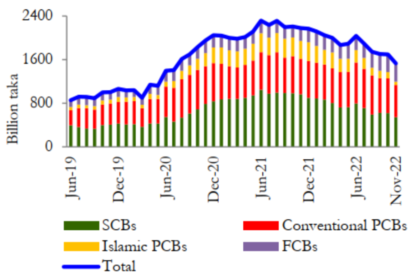
CREDIT SCENARIO

- In H1'FY23, actual growth rate of the broad money was 8.4%, lower than the target rate of 10.0%. For H2'FY23, target for broad money growth is revised at 11.5%, 60 bps lower than earlier.
- In H1'FY23, programmed growth for reserve money was 9.0%. For H2'FY23, the target is revised at 14.0%, 500 bps higher than earlier.
- In H1'FY23, actual private sector credit growth was 12.8%, lower than the target of 13.6%. Public sector credit growth came at 26.6%, which was below the target of 33.3% as well.
- Domestic credit growth was in line with the target (15.1% actual against target of 16.9%), due to the reversion of momentum in economic activities after overcoming the impact of the COVID.
- For H2'FY23, target private sector credit growth is set at 14.1%, similar to previous projection. Public sector credit growth revised at 37.7%, 170 bps higher than earlier. Domestic credit growth target for the same period is revised at 18.5% from 18.2%.
- BB has taken various initiatives in H1'FY23 such as continuous liquidity supports to the conventional banks through repo, liquidity support facility and Islamic bank liquidity facility (IBLF) for Shariah based banks and so on. In H1'FY23, BB sold USD ~7.8 Bn in the market to offset foreign exchange pressures, which helped to reduce excess reserve from the system. Reduction in excess reserves contributed to decline in overall excess liquidity in the economy. Excess liquidity stood at BDT 1.53 Tn as of Nov'22, down from BDT 2.03 Tn in Jun'22.
- **Analyst Comment:** Due to the reversion of momentum in economic activities after overcoming the impact of COVID from successful vaccination campaign, the private sector credit growth has been strong during H1'FY23. However, a substantial depreciation in BDT against USD with the rising commodity and raw material prices in the global market affected inflation, foreign reserve and current account balance, among others. BB's action to ensure supply of foreign currencies for imports contributed to reduction in Net Foreign Assets, which in turn increased reserve money. The Government's budgetary revised target of borrowing BDT 1.1 Tn from the banking system, where Government has already borrowed BDT 0.3 Tn in H1'FY23. However, the relatively lower amount of government borrowings from non-bank (sale of national savings certificate) and foreign sources have significantly increased the amount of public sector credit provided by the banking system. Higher subsidies owing to rising fuel and fertilizer prices in the global market contributed to the buoyant public sector credit demand. Inflows of foreign funds and mobilisation of idle funds from the state-owned enterprises (SOEs) offset some of the demand.

Liquidity

- Broad money growth was lower than targeted for H1'FY23. Excess reserves were shrinking and had some shortfall cases for Islamic segments.
- Excess liquidity seems to head toward pre-pandemic level base, with relatively higher concentration to PCBs and weaker position for ICBs and SCBs. Excess reserves fell ~75% within Jun-Nov 2022, while excess liquid assets dropped by ~25% within same time.
- BB is moving up the interest rate corridor as liquidity stretch in banking system has raised call money beyond the previous boundary, and immediate cool off is not expected.
- With the rate corridor staying above average deposit rate and sticking to upper end of current call money rate, BB is pushing banks to go for cheaper deposits, while raising cost of fund from BB for banks.

Chart 16: Movement of Excess Liquid Assets

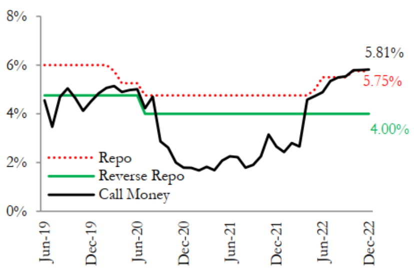


Source: Bangladesh Bank

Exchange rate

- Gradually move toward a market based, unified and flexible exchange rate regime (within 2% variation) by June 2023.
- With the variability target mentioned, we expect BB to remain active toward maintaining BDT value and avoid any abrupt volatility in exchange rate.
- The exchange rate of USD/BDT currently stands at BDT 105.53. However, BDT depreciated 11.3% during H1'23, reflecting excess foreign exchange demand due to the hike in global oil and commodity prices. In addition, an appreciation of USD and sluggish growth in the remittance inflow added pressure on foreign exchange rate. Meanwhile, addressing the increased demand for foreign exchange, Bangladesh Bank (BB) sold around USD 7.6 Bn in FY'22 and USD 12.9 Bn during CY'22.

Chart 17: Movement of Call Money and Policy Rates



Source: Bangladesh Bank

FX Reserve

- Current account deficit during Jul-Nov 2022 stood at USD 5.7 Bn. As a result, Foreign Exchange Reserve stood at USD 32.5 Bn.
- **Analyst Comment:** While multi-pronged approach of BB worked to hold the rush of import growth so far, the sizable gap in trade persists as a threat to external account health. Higher deficit in service account from rising shipping costs added more strain to CA balance. Remittance is not filling up the gaps as previous periods, and BB hopes its various actions to aid improve remittance, also including the fact that overseas employment has gone up. BB is banking on raising export and reducing imports and getting mild remittance growth to cover up the pressure on reserves by Jun 2023. However, deficit is expected for Jun 2023.

CURRENT ACCOUNT DEFICIT

- Following buoyant export & import growth in FY22, H1'FY23 saw contrasting performance on the external front, leading to some improvement in the current account deficit. Export saw moderate growth (10.6% YoY) in H1'FY23 driven by demand for RMG. Meanwhile, import restriction, currency depreciation, and moderation in selected commodity prices helped to oversee import degrowth of 2.2% YoY during the period. Exchange rate volatility, rising living costs in source countries, and some inflow through the unofficial remittance channel arrested expected growth on the remittance front in H1'FY23. As a result, remittance inflow reached USD 10.5 Bn during the period, clocking 2.48% growth YoY.
- Following H1'FY23 performance, BB expects FY23 trade deficit to reach USD 20.9 Bn, a significant upward revision compared to FY23 MPS projection of USD 36.7 Bn. BB expects the export growth and import growth moderation would continue down the line. Potential uptick in remittance in H2'FY23, particularly during the Eid festival, could improve current account deficit to USD 6.8 Bn by the end of FY23 (against previous target of USD 16.5 Bn).
- During H1'FY23, shortage in trade credit (net) pushed financial account balance into negative territory. BB expects some improvement on this front down the line, which could help keeping reserves close to USD 36.5 Bn by the end of FY23.
- While the projection seems to represent an obtainable GDP growth picture, BB recognizes certain headwinds that may jeopardize achievement, including: 1) prolonged & intensified Russia-Ukraine war 2) the spree of interest rate hikes by US Fed, and 3) Re-emergence of COVID-19 situation and severity in China. Against such significant external issues, BB is confident about the economy's resilience to weather the current condition.

(All Figures in USD Mn)

	Actual FY'22	Target FY'23	Revised FY'23	YoY Growth Actual (FY'22)	YoY Growth Revised (FY'23)
Trade Deficit	33,250	36,705	20,901	39.84%	-37.14%
Remittance	21,032	24,505	21,873	-15.12%	4.00%
Current Account Deficit	18,639	16,546	6,818	307.41%	-63.42%
Current Account Deficit as % of GDP	4.1%	3.5%	1.4%		
Financial Account Balance	13,775	16,016	2,800	-2.08%	-79.67%
Gross International Reserve	41,827	42,500	36,500	-9.84%	-12.74%

Source: Bangladesh Bank MPS

Note: FY23 current account deficit (% of GDP) is extrapolated from figures provided in MPS, FY22 figure taken from IMF

Additional: IMF Loan and Implication of MPS H2'FY23

- BB had its latest meeting with IMF top level delegation on Jan 15, 2023. Per the BB spokesperson brief, IMF is to finalize the loan engagement by end Jan (Jan 31, 2023 meeting, which could not be confirmed from IMF website), and the first tranche funding is expected by February 2023.
- Per our observations, the latest MPS broadly corresponds to typical IMF conditions, highlighting (i) moving toward floating exchange rate (the timeline is June 2023, which is ideally before the second tranche), (ii) declaration of removal of certain interest rate protectionism (deposit floor and consumer loan ceiling) with indication of removal of other ceilings in "suitable" situations (iii) mentioning the potential need to revise energy prices at tandem with global prices, aligning with typical IMF agenda of eliminating subsidies (iv) planned and in progress NPL & governance related actions to address weakness in the banking system. Also, we note that providing MPS more than a year itself was an IMF ask per last visit details from reputed media.
- Hence as a pretext of IMF funding discussion, latest MPS H2'FY23 aligns well.

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